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Regularity Audit Framework

2006

This document is of interest to FE colleges receiving LSC funding, auditors of FE colleges and LSC staff

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Regularity Audit Framework

Summary

- 1 The Learning and Skills Council (LSC) funds further education (FE) colleges through a Financial Memorandum. The Financial Memorandum requires the college to make audit arrangements in accordance with the LSC's *Audit Code of Practice* (LSC, 2004) (the Code). The Code has been revised for the funding year 2004/05 and beyond. The Code is given as LSC Circular 04/07.
- 2 Under the Code, for 2004/05 onwards, the LSC has removed its requirement that most colleges are subject to an annual funding audit. The LSC is however requiring all colleges to appoint their financial statements auditors to give an opinion to the LSC and to colleges on the regularity of colleges' expenditure. This framework sets out the LSC's expectations of colleges and their financial statements auditors, acting as regularity auditors, in giving this regularity audit opinion. The framework forms the basis of the terms of engagement with the audit providers.
- 3 Colleges are required to obtain, from their financial statements auditors, an audit report on regularity to be published as part of their financial statements. This report will be addressed to both the college governing body and the LSC. The model letter of engagement (Supplement D to this framework) provides for this. Colleges that do not meet the criteria at paragraph 18 of the framework are additionally required to commission an interim regularity audit report in respect of the period 1 August to 31 March and to submit this interim regularity audit report to the LSC **by 31 May**. The requirement for regularity audit reports applies to all colleges, whether or not they are in plan-led funding.
- 4 The key change in the framework for 2005/06 onwards is that in 2004/05 an interim regularity audit was required for all colleges. This is no longer the case. The LSC determined, on the advice of the NAO, that following the experience of 2004/05, the interim regularity audit would not be necessary for any college where the LSC were satisfied that the college would be able to identify and report any material irregularity or impropriety arising. The LSC consulted on this proposal in November and December 2005, and respondents were overwhelmingly in favour. The proposal is therefore implemented in this revision of the framework.
- 5 This framework will be updated annually to take account of changing requirements. The LSC will review the quality of the work of regularity auditors against this framework in giving their opinion. The LSC will keep under review the continuing need for the framework.
- 6 For practical purposes, this framework is in two parts:
 - a self-assessment by colleges and collation by colleges of information to support the regularity audit. The self-assessment and list of information are issued as Supplement A to this framework. The

self-assessment and information should be completed by colleges and given to their regularity auditors according to an audit timetable to be set up between the two parties.

- a regularity audit programme guide to support regularity auditors in their work in giving their regularity opinions. This guide is issued as Supplement B to this framework.
- 7 The framework is also supplemented by a model interim regularity audit report (issued as Supplement C) and letter of engagement (issued as Supplement D). The standard form of the final regularity audit report is included in the Casterbridge College model financial statements contained in the LSC's Accounts Direction Handbook for colleges.

Status of Framework

- 8 The LSC has issued this framework to support colleges and their regularity auditors in achieving a common standard in the discharge of their responsibilities for controlling and reporting on the regularity and propriety of colleges' expenditure. The LSC however sees colleges' primary responsibility under their Financial Memoranda for securing regular and proper expenditure as being with college governors and the principal as the accounting officer. As the governors appoint the principal, they also have a responsibility for regularity and propriety as part of their overall responsibility for the conduct of the college. Under the LSC *agenda for change*, the LSC is clear that regularity audit, or any other audit, are no substitute for colleges' own discharge of their responsibilities.
- 9 It is therefore for colleges and regularity auditors to do whatever they think are necessary to deliver on their respective responsibilities. This may mean doing more or less than the approach set out in the framework. In any event, the regularity auditor should do whatever work that, in their professional judgement, they consider necessary in order to support their audit opinion.

Scope of the Regularity Audit

- 10 Regularity auditors must form an opinion over the regularity and propriety of all college spending, regardless of its source. Annex A to this document gives available and accepted definitions of regularity and propriety.

Principles of the Regularity Audit Approach

- 11 The underlying principle of the regularity audit is that it is an audit of the **regularity of college activities and classes of transactions**. As a result, regularity auditors, when planning their work, need to identify the individual activities of the college. This is the same approach as is adopted for the 'true and fair' audit performed by the financial statements auditor, who is concerned in ensuring that, materially, the constituent activities and associated transactions when recorded within the financial statements give a true and fair view.

12 Table 1 sets out the principal activities that need to be considered.

Table 1: Principal college activities and transactions subject to regularity audit.

Activity	Teaching and learning (T and L)			Ancillary activities related to T and L (catering, residencies and so on)	Commercial activities (often run through subsidiaries)
Funding	LSC-funded activity	Other funding activity	Mixed funded activity	Various external sources	Various external sources
Expenditure	Core college (estates, staff and so on)			Core college and/or discrete costs	Discrete costs
	Non-core college (third-party payments, staff and so on)				

13 Other activities include:

- HM Treasury management activities
- capital programmes.

14 The financial statements auditor's approach to auditing the activities of the college in giving a 'true and fair' opinion is informed by the income and cost structure of each activity (and sub-activity). For example, the financial statements auditor will take a different approach to auditing teaching activities where payments are to third parties and linked to activity levels (for example, under franchising), than for other teaching activities.

15 Equally, if funding has been provided for a certain activity, the college would monitor its expenditure on that activity, either within the cost-centre structure of its ledger or through other reporting and monitoring mechanisms. The financial statements auditor would then consider whether the financial statements reflect an appropriate match of income and expenditure.

16 The regularity audit should therefore be seen as an extension to the 'true and fair' audit work undertaken in each area of activity. How much extra work will be needed in addition to the financial statements audit depends on:

- materiality
- the level of regularity assurance required by the LSC
- whether the regularity auditor assesses the college's controls over a particular activity as adequate and effective.

Timing of Regularity Audit

- 17 Colleges are required to submit their regularity audit report to the LSC as part of the college's financial statements, and the same timetable as for submission of college financial statements to the LSC therefore applies.
- 18 Some colleges are additionally required to submit an interim regularity audit report. These colleges are those which do not meet one or more of the following criteria:
 - The college is in plan-led funding.
 - The college's financial statements for the previous financial year were submitted to the LSC by 31 December.
 - The college received an unqualified interim regularity audit report for the previous financial year (if such report had been required).
 - The college's financial statements for the previous financial year contained an unqualified regularity audit report.
 - The college's internal audit annual report for the previous financial year was unqualified and submitted to the LSC by 31 December.

Colleges will be advised annually by their regional audit manager whether or not an interim regularity audit report is required. In each case where a college is advised **for the first time** that it is no longer required to submit an interim regularity audit report, the college governors must submit a statement on regularity, propriety and compliance in the form at Supplement F to the regional audit manager by 30 April. If the college governors do not wish to make the statement, or the statement is not received by 30 April, the LSC will require an interim regularity audit report. Supplement F also contains suggestions as to the evidence governors might consider in making their statement.

- 19 The interim regularity audit report, where required, should cover the period from 1 August (the start of the college's financial year) to 31 March. The interim report is required by the LSC **by 31 May** in order for the LSC to obtain assurance from it in the preparation of its own financial statements for the year to 31 March.
- 20 Auditors should send interim regularity audit reports (where required) to the LSC, copied to the college, by 31 May. Final regularity audit reports will form part of the financial statements. Interim regularity audit reports should be sent to the relevant provider financial assurance (PFA) regional audit manager. Contact details for the regional audit managers are on the LSC's website (www.lsc.gov.uk/National/Documents/SubjectListing/FundingLearning/ProviderFinance/ProviderFinancialAssurance/Contactdetails.htm).

Performing the Regularity Audit

- 21 The regularity auditor should plan to carry out the regularity audit as far as possible at the same time and integrated with their financial statements audit work. The regularity auditor should endeavour as far

as possible to take account of other audit work done at the college, such as internal audit, to avoid duplication of work. Guidance on this point is given in the HM Treasury Booklet *Cooperation between Internal and External Auditors: A Good Practice Guide*.

- 22 Where the regularity auditor identifies an issue that could result in a qualification of his or her audit report, the issue should initially be discussed with the college. Where the college and the auditor cannot agree, the issue should be referred to the LSC for resolution. In exceptional circumstances, the auditor may consider it necessary to report the issue directly to the LSC.

Form of Engagement and Duty of Care

- 23 As the regularity audit report(s) are addressed to the LSC as well as the college, the LSC needs to be a party to the financial statements audit engagement letter. The model letter is issued as Supplement D to this framework.

Quality Assurance Arrangements

- 24 The LSC will wish to assure itself of the quality of work undertaken by the regularity auditors. The LSC will wish to take on board the firms' own quality assurance arrangements over this work and supplement this with sample reviews of the firms' quality assurance work. Sample reviews will only consider work directly related to the regularity audit and not work undertaken to provide a true and fair opinion. The LSC will require access to the relevant working papers.

Annex A: Definitions of Regularity and Propriety

Regularity

- 1 The provision of a regularity opinion is an established part of the audit of central government bodies, and the process is set out in Auditing Practices Board (APB) Practice Note 10 (Auditing Practices Board, April 2001):
- 2 APB Practice Note 10 has the following definition of regularity:
Regularity can be defined as the requirement that a financial transaction should be in accordance with:
 - *authorising legislation;*
 - *regulations issued under governing legislation;*
 - *Parliamentary authorities; and (where relevant)*
 - *Treasury authorities.*
- 3 Regularity tends to relate to classes of transactions (generally linked to distinct activities) rather than individual items.
- 4 Regularity is defined in the *Government Accounting Manual* (HM Treasury, 2000) (*Government Accounting*) as:
The requirement for all items of income and expenditure to be dealt with in accordance with the legislation authorising them, and any applicable delegated authority and the rules of Government Accounting.
- 5 Regularity is **not**:
 - giving an assurance about compliance with all relevant laws and regulations applicable to the college
 - a requirement for a detailed scrutiny of every financial transaction conducted by the college.

Propriety

- 6 There are no easy definitions of propriety. The basic test is whether a college's spending is something that it would be able to defend to the general public as proper spending by a public interest body.
- 7 The Nolan Committee's *First Report of the Committee on Standards in Public Life* (Nolan Committee, May 1995) used a broad definition of propriety:
We take propriety to encompass not only financial rectitude, but a sense of the values and behaviour appropriate to the public sector.
- 8 However, the definition of appropriate behaviour is not constant but changes over time with public and parliamentary expectations. While

acknowledging the wide compass of propriety, public sector auditors are especially concerned with matters that impact upon the finances or governance of the bodies they audit. This focus is reflected in the definition of propriety provided in HM Treasury's guidance *Government Accounting* (HM Treasury, 2000):

Propriety is the requirement that expenditure and receipts should be dealt with in accordance with Parliament's intentions and the principles of Parliamentary control, including the conventions agreed with Parliament.

- 9 Additionally, the Auditing Practices Board (APB) provides a useful footnote that distinguishes propriety from regularity in APB Practice Note 10 (Auditing Practices Board, April 2001):

Whereas regularity is concerned with compliance with appropriate authorities, propriety goes wider than this and is concerned more with standards of conduct, behaviour and corporate governance. It includes matters such as fairness and integrity, the avoidance of personal profit from public business, even-handedness in the appointment of staff, open competition in the letting of contracts and the avoidance of waste and extravagance.

- 10 The approach put forward in this document fulfils the intention of APB Practice Note 10 and follows broadly the approach, recognising the different aspects of regularity within the FE sector.

Parliament's intentions and authorities

- 11 A college can only do that which Parliament has given it powers to do. The intention of Parliament is put into practice mainly through passing Acts of Parliament giving legitimacy for action to meet the stated aims. Some Acts place very closely defined duties and limits on the Government; others provide wide discretionary powers about what and how activities are undertaken. Acts of Parliament may also require the detail of what should happen to be defined in regulations. These are more commonly known as Statutory Instruments (SIs) and are binding in the same way as an act of Parliament.
- 12 The main statutory framework for colleges is laid down in the Further and Higher Education Act 1992 (HM Government, 1992) (the Act). Powers under the Act are set out in Table 2.

Table 2: Powers under the Further and Higher Education Act 1992.

Activity (extracts)	Statutory power
<ul style="list-style-type: none">• provide further and higher education;• supply goods or services in connection with their provision of education	s18 Further and Higher Education Act 1992 (Principal Powers)
<ul style="list-style-type: none">• anything which appears to the corporation to be necessary or expedient for the purpose of, or in connection with, the exercise of their principal powers	s19 Further and Higher Education Act 1992 (Supplementary Powers)

- 13 Through delivery of the provisions of the Act and other related legislation such as the Learning and Skills Act 2000 (HM Government, 2000), regularity requirements impacting on colleges are contained within:
- the Financial Memorandum between the college and the LSC
 - each college's Instrument and Articles of Government
 - the recurrent funding guidance issued annually by the LSC, aspects of which are derived from the Learning and Skills Act 2000 (HM Government, 2000), the Education (Fees and Awards) Regulations 1997 (HM Government, 1997) and supplementary legislation such as the Immigration and Asylum Act 1999 (HM Government 1999)
 - certain LSC circulars.
- 14 In addition, the draft Charities Bill (UK Parliament, 2004) (the Bill) potentially places further requirements on the LSC, as the intended principal charity regulator for colleges, and on colleges themselves. In particular, the Bill highlights the requirement for colleges, and the LSC as regulator, to be concerned with the application of assets of a charity regardless of their source. Subject to any changes to the Bill as it progresses to statute, the LSC is directly concerned with the 'use of funds' from other sources. The regularity audit is concerned with the regularity of financial transactions within this framework.
- 15 The legislative framework does not extend to non-financial matters such as health and safety, even though non-compliance could have financial consequences. It is also the case that the focus is upon the regularity of classes of transactions, rather than upon individual transactions. While there could be instances when an individual transaction is material to the whole account, this is unlikely, and recourse to individual transactions would normally only be required if there was evidence discovered raising doubts about a particular type of transaction.
- 16 Fraudulent transactions cannot, by definition, be legitimate since they are without proper authority. Fraud that is material to the financial statements would lead to a qualification of the regularity opinion.

Annex B: Bibliography and References

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